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The President's Daily Brief

October 3, 1975

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FOR THE PRESIDENT ONLY

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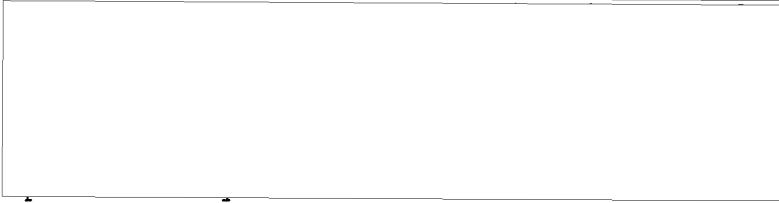
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LEBANON

The security situation in Beirut improved yesterday after a night of clashes and sniper fire between Christian and Muslim militiamen in the southern suburbs. Lebanese security forces took over positions of the Christian Phalanges Party in those areas and were attempting to work out a similar agreement with Muslim and leftist elements.

Palestine Liberation Organization officials reportedly blame the fedayeen "rejectionist" organization, the Popular Front for the Liberation of Palestine-General Command, for the incident that began the most recent fighting and wave of kidnapings. The "rejectionists" and the Lebanese leftists apparently believe that continued violence will result in the establishment of a regime more sympathetic to their interests.

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The future of the national reconciliation committee continues to be in doubt. Moderate Muslim leader Saeb Salam has joined Christian moderate Raymond Edde in announcing that he is reconsidering his membership in the group. Their move is apparently part of an effort to force the resignation of President Franjiyah--a step both have publicly called for. Salam indicated that the move was not aimed at either Prime Minister Karami or Interior Minister Shamun.

Edde and Salam are members, along with Karami, of a centrist alliance of Lebanese parliamentary deputies. Edde, as a Christian Maronite, considers himself a candidate to succeed Franjiyah should the latter resign before his term expires next August.

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Because of Franjiyah's close identification with the hard-line Phalangist position, Lebanese moderates, both Christians and Muslims, see the resignation of the President as a necessary step in the achievement of a compromise whereby the Christians would cede some political and economic power to the Muslims.

Without fanfare, Prime Minister Karami has given the army a larger role in preventing further flare-ups. He is moving cautiously, however, to avoid the political controversy that abrupt military intervention would excite. Lebanese Muslims believe that the army, whose senior officers are mostly Christian, would inevitably side with the Phalangists if it became directly involved in any further fighting. The army's new mission is restricted to protection of main lines of communication and relief of civilian security forces stationed in outlying areas to free them for service in enforcing the cease-fire in Beirut and Tripoli.

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EGYPT-USSR

Our embassy in Cairo has provided an assessment of President Sadat's motives in so harshly attacking the Soviets, as well as a review of the relative strengths and weaknesses of the Egyptians and the Soviets in their dealings with each other.

Sadat's distrust of Moscow has clearly reached the scale of a personal phobia. He has concluded-- and said as much publicly--that the Soviets not only want to replace him as president, but also that their policy of pressure on Egypt during the past ten years has been a contrived strategy to prevent Egypt from becoming strong and therefore immune to Soviet pressure. As long as Sadat is in power, Egypt is unlikely to enter into new undertakings with the USSR if these require acceptance of Moscow's good faith. The exception would be if the US should let him down. In that case, Sadat might have to eat crow.

The question that intrigues diplomatic observers is what Sadat expects to gain--other than enhanced popularity--from constant public irritation of the Soviets.

Without adequate spare parts for Egyptian military equipment supplied by the Soviets, the armed forces would soon be, or may already be, in a bad way. Egypt's military imbalance with Israel is already unfavorable, and reports of massive US arms aid to Israel have created major problems for Sadat.

As Egypt's military inferiority becomes more obvious, Sadat's protestations that he has not made a separate peace will lose any semblance of credibility. Potentially more dangerous is the probable adverse reaction within the Egyptian military to a continuing shortage of new arms and spare parts in the face of Israel's growing power.

the USSR imports large quantities of Egyptian agricultural and industrial products and that a great many poor Egyptians would be hurt if the Soviets were to stop these imports.

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[redacted] the Soviet market is important for Egyptian cotton [redacted] if bilateral trade were to cease, Cairo would have to seek essential raw materials, now obtained from the USSR and Eastern Europe, in hard currency markets. This would be a severe blow to Egypt's already dismal foreign currency situation.

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The Soviets pose an internal threat through their influence with both underground communists and the labor and student movements. This is, however, a threat that Egyptian security authorities monitor carefully. Party members and communist-influenced organizations are not believed to be sufficiently influential to threaten Sadat on their own, but they could play a crucial role in exploiting social and economic grievances.

In the face of this very substantial Soviet capability to damage Egypt, what weight can Sadat bring to bear on the USSR to prevent further Soviet action and still obtain what he needs from Moscow?

There is first Egypt's pivotal role in Arab affairs and in the Arab-Israeli conflict. Sadat probably reasons that, unless the Soviets decide to opt out of the Middle East, they cannot risk a complete rupture with Egypt.

Sadat has also been careful not to eliminate the most important remaining Soviet interest--continued use of naval facilities at Alexandria. The Soviets enjoy no other port facilities in the Mediterranean comparable to those in Alexandria and are presumably willing to put up with verbal abuse in order to keep them.

Finally, the Soviets would appear to have a strong interest in maintaining the most extensive presence they can inside Egypt in the hope that, by design or by accident, they will soon see Sadat replaced.

On balance, both parties have a considerable interest in avoiding a further deterioration of relations.

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NOTES

EC foreign ministers are expected to approve on Monday a program of economic assistance for Portugal.

The ministers have invited Portuguese Foreign Minister Antunes to Luxembourg on Tuesday to discuss an initial aid package that will probably total about \$200 million in loans from the European Investment Bank over a two-year period. The loans will be tied to specific project proposals. EC recognition of Lisbon's moves toward "pluralist democracy" is likely to pave the way for assistance from West Germany and the Netherlands.

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WEST GERMANY

During his first 18 months in office, Chancellor Schmidt established himself as the most active European leader in international diplomacy. Today, however, economic problems are causing some anxiety, and Schmidt has had to pay attention to domestic concerns. German voters, accustomed to sustained economic growth and low unemployment, are increasingly disturbed that Schmidt has not yet reversed the recession. Unemployment remains at 1.1 million, the highest in 20 years, and could reach 1.5 million this winter. Despite the economic problems, Schmidt's Social Democrats and their coalition partners, the Free Democrats, have a solid majority in parliament. Consumer prices in August were only 5.9 percent higher than a year ago, the lowest in the industrialized world, and there are few signs of social unrest.

Schmidt's program to get the country's stagnant economy on the upswing is a mixed bag. In August, he proposed anti-recession measures by ticketing \$2 billion for housing and construction. At the same time, he began to look for ways to cut the federal deficit which will reach about \$16 billion this year--equal to three percent of the GNP--and threatens to increase again next year. He is seeking parliamentary approval for selective tax increases and limiting spending increases to cut the deficit to \$4 billion by 1979.

The opposition Christian Democrats argue that this belt-tightening is not enough but, so far, have been unwilling to specify what further cuts they favor. Their reluctance stems partly from their fear that additional cuts might have to come out of the defense budget and social welfare programs--areas that could cost them votes. The Christian Democrats reject Schmidt's proposal to increase taxes on wages next year and a 2-percent increase in the value added tax to 13 percent in 1977. They want tax breaks for industry to stimulate investment and employment.

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Political Side-Effects

Conflicting pressures for austerity and pump-priming complicate Schmidt's standing within his party and with the trade unions. The party's left wing is disturbed that the government's tight budgetary policy continues to postpone implementing the social reforms promised by Schmidt's predecessor, Willy Brandt. Trade union leaders at present support Schmidt's austerity program, largely because the government also opposes wage and price controls, but if tax breaks are granted to industry this could unleash demands for wage increases from union rank and file.

The Chancellor may face some criticism from the left wing at the annual party congress in Mannheim next month. But with the support of Brandt, who now seems content with his role as party chairman, Schmidt should encounter no serious challenge to his leadership. His popularity with voters is higher than that of the party, which lost seats in all six state elections this past year, including Bremen last Sunday. The losses would have been even greater were it not for Schmidt's dynamic leadership. Most Social Democrats realize that Schmidt's conservative style lubricates the coalition with the Free Democrats, and that he must head the party's ticket next year if the Socialists are to win.

Relations with Washington

The Chancellor believes that his chances for reelection will depend, to a large extent, on an upswing in the US economy that presumably will trigger a corresponding improvement throughout the industrial world and increase demand for German goods. Schmidt accordingly favors proposals to increase coordination among the four or five leading Western industrial states on fiscal and monetary policy, but he wants to avoid institutional forums that probably would antagonize the smaller members of the European Community.

While in Washington, he may want to explore whether US officials plan any further anti-recessionary measures. He feels that Washington is overly concerned with inflation and is following excessively restrictive monetary and fiscal policies.

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The Schmidt government views high US interest rates as a harbinger of future measures that will slow the pace of US expansion. Additionally, he will contend that the gap between US and West German interest rates--6.8 percent versus 3.8 percent for respective short-term rates--is helping to frustrate Bundesbank attempts to stimulate the economy.

Cuts in the German discount rate have done more to trigger capital flows out of marks into dollars than to boost domestic investment. This phenomenon is part of the general problem of the volatility of the dollar-Deutsche mark exchange rate, a problem of considerable concern to the Chancellor.

Any renewed calls by Schmidt for synchronizing recovery efforts, however, will ring hollow, given his intention to raise taxes and cut government spending for next year. For the moment, his program reflects a judgment that the long-run dangers of large government deficits are greater than the political and economic costs of the current recession. He counts on Washington to take the lead in anti-recession policy. [redacted]

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Schmidt also views the financial difficulties of New York City with trepidation. He fears that a default on NYC bonds could send shock waves throughout international capital markets. Collapse of the Herstatt bank last year and its repercussions still are fresh in his mind. The Chancellor will diplomatically seek information on Washington's plans.

Schmidt devotes little attention to defense issues. He and Defense Minister Leber, nevertheless, share a strong conviction that nothing should be allowed to jeopardize the security tie to the US. This factor is undoubtedly playing a role in Schmidt's attitude toward Washington's demand for another offset agreement--a "bitter pill," in his view, given the tight budget. The Chancellor wants to avoid the "rigid" formal agreements of the past and, according to one report, may propose in Washington that future arrangements be placed on a multilateral basis, including other NATO allies.

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Bonn would also voluntarily offset some of the cost of stationing US troops in the Federal Republic by buying US weapons and depositing official funds in the US. The last two-year bilateral agreement, which expired in June, made such actions obligatory.

Bonn does not always see eye to eye with the US and other West European countries on the energy problem. Schmidt supported Washington on creating the International Energy Agency. But like most of their neighbors, the West Germans want to avoid confrontation politics with OPEC. At Schmidt's direction, Bonn officials are reviewing policy on commodity markets and development aid to ensure fruitful dialogue with the oil and raw material producers at the energy conference in Paris this month.

As far as relations with the East are concerned, Schmidt conducts Ostpolitik not on the basis of the visionary political goals of Brandt, but on a cold calculation of the state of Bonn's relations with Moscow and its allies. This does not mean that the Schmidt government has lost interest in humanitarian and security issues. The Chancellor has shown a high degree of flexibility in maintaining the appearance of progress with the East Germans and Soviets on Berlin matters, and with the Poles on the repatriation of ethnic Germans.

His underlying concern is to minimize political friction in order to foster a favorable climate for trade with the East. He emphasized in his opening speech to parliament the growing importance of Eastern trade for the German economy. The Eastern countries now purchase nearly 10 percent of Germany's exports and account for a large share of the nation's trade surplus.

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